

The tiger in front

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India can learn much from China's breakneck economic expansion. But it has valuable lessons for China, too, argues Simon Long

HOME to nearly two-fifths of humanity, two neighbouring countries, India and China, are two of the world's fastest-growing economies. The world is taking notice. In December, a report by America's National Intelligence Council likened their emergence in the early 21st century to the rise of Germany in the 19th and America in the 20th, with "impacts potentially as dramatic".

Comparisons between the two are inevitable. Both are poor, largely agricultural, countries that have made great strides in reducing poverty, especially since embarking on radical, liberalising economic reform. But India and China, always very different civilisations, have followed very different paths to growth. Under reform, they have converged somewhat in the past two decades, but will remain distinctive.

Take the way the two countries reacted to the recent deaths of two reformist leaders. India's P.V. Narasimha Rao, who died in December, was prime minister of India in 1991, when his government rescued the country from financial crisis and launched India's economic reforms. He served until 1996, but was later convicted of corruption. Although he won an appeal, the taint never quite left his name. His death, however, was marked by a state funeral and seven days of official mourning. The media vigorously debated his legacy.

When Zhao Ziyang, a former Chinese prime minister and head of the Communist Party, died three weeks later, he got just a couple of lines from the official news agency. He had been out of favour for siding with student protesters in Beijing's Tiananmen Square against hardliners in his own party in 1989. Dissidents were prevented from attending his funeral. It took two weeks to negotiate an official obituary. His successors, nervous that his memory might evoke the bloody suppression of the protests, did their best to erase it.

That India is an open society and China is not is one of the most glaring differences between the two. Some people in both countries are tempted to use it to explain another: that China's economy has grown much faster. This survey will argue that this view is simplistic and misleading.

Some of the main reasons for China's better performance have nothing to do with the political system. When China started its reforms, in 1978, it was poorer than India. Part of the gap now is due simply to that earlier start. But also, unreformed China seems to have done a more impressive job than India did in educating and providing health care for its poor. Reforms benefited from what economists call "good human capital", and from a bulge in the working-age population that India itself is now experiencing.

In terms of integration into the global

A list of acknowledgments and sources can be found online at

www.economist.com/surveys

An audio interview with the author is at

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Country guides to India and China can be found, respectively, at

www.economist.com/india

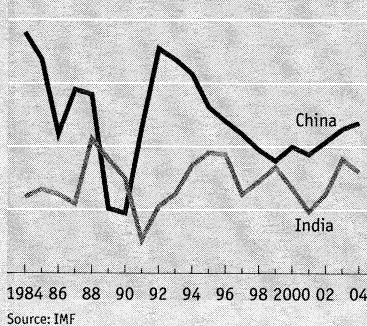
www.economist.com/china

► economy, the Chinese reforms have gone much further than India's have, and reaped bigger rewards. But India and China still face similar challenges. When George Fernandes, an Indian opposition politician who was defence minister in the previous government, visited China in 2003, he asked China's prime minister, Wen Jiabao, to list his economic priorities. The answers—unemployment, regional disparities and the enduring poverty of farmers—applied just as much to India. Mr Fernandes, once known as a critic of China, concluded: "We are both sailing in the same boat."

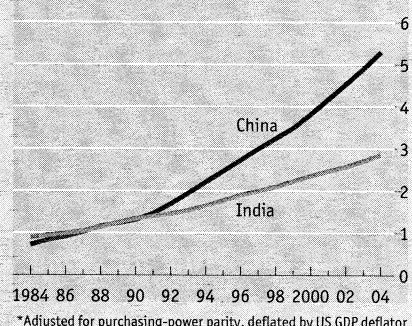
The two countries have much else in common. Both have massive populations with correspondingly massive needs for resources, especially land, water and energy. Both need to find ways of stemming environmental decay. Both suffer under-reported HIV infection rates. Both face potentially destabilising external disputes: China with America over Taiwan, India with Pakistan over Kashmir.

How a tiger earns its stripes

GDP, % increase on a year earlier



GDP per person at 2004 PPP*, \$ '000



Both, moreover, have each other: as model or as warning, and as so far largely unexploited economic opportunity. This survey will argue that there are lessons India can draw from China's experience, but that the "Chinese model" need not mean anything resembling its political authoritarianism. In that respect, India has much

to teach China.

India is often portrayed as an elephant: big, lumbering and slow off the mark. Now investment-bank reports are beginning to talk of it as a new Asian "tiger". If that is what it wants to be, it makes sense for it to study China: the tiger in front is Chinese. ■

The great divide

If this is a race, India has already been lapped

RETURNING to visit Beijing or Shanghai after a few years' gap is a bewildering experience. After negotiating slick new airports, new expressways whisk you into town. Occasionally, through the new skyscrapers, a familiar building appears, lost in the concrete jungle. Parts of China have seen perhaps history's biggest construction boom.

A return to Delhi or Mumbai, by contrast, is a reassuring if frustrating experience. The only great innovation in the airports (and don't knock it) is an improved

queuing system in the crowded immigration halls. The roads into town are clogged at night with lorries bearing redundant injunctions to "horn please". In the traffic jams, cripples and young mothers with babes in arms beg at car windows. There are new buildings and roads, and, in Delhi, a splendid new underground railway. But these cities are still themselves. Whereas its neighbour has been transformed out of all recognition, India has, in most visible essentials, stayed the same.

Measuring this difference is difficult. In-

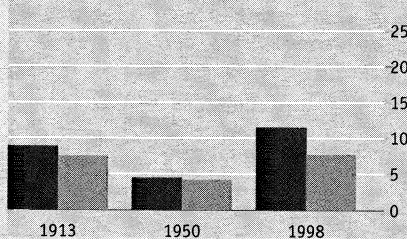
dians object that Chinese statistics are fudged or concocted by local officials trying to impress their superiors. They do not add up. When the government said, "Speed up!", the numbers exaggerated growth. Now that the government says, "Slow down!", they understate it. Yet in broad terms, the trends they show and the story they tell—of China's outperforming India—make sense, and fit the evidence of the eyes. Statistical objections are just one symptom of an Indian state of denial.

Many Indians have little patience for foreigners who cannot see beyond the airports and the beggars to the many wonders of India—including its recently fast-growing economy. Some foreigners are equally intolerant, wondering why they should see beyond such inefficiency and poverty, and how their hosts have managed to do so for so long. The changes in China have given them another stick to beat India with.

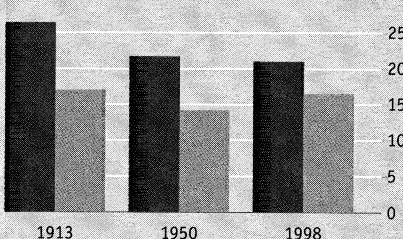
Yet there are beggars in China too, and the divergence in the data is a recent phenomenon. Measured by purchasing power per person, China's GDP did not overtake India's until the early 1990s. Since

Jockeying for position

Share of global GDP, %



Share of global population, %



It's the people, stupid

THE numbers, as ever, are disputed; but it seems beyond doubt that China is ageing faster than any other country in history. It is unique in growing old before it has grown rich. The "one-child" policy introduced in 1980 was soon relaxed to allow many people in the countryside to have two children if the first was a girl. The restrictions were also widely flouted by those who could afford a fine or a bribe to pay for extra children.

Even so, the policy has had a dramatic effect. China says 300m births over the past 30 years have been "averted". That means 300m fewer mouths to feed, but also 300m fewer workers and 300m fewer offspring to lavish Confucian respect on their forebears. In the coming decades China will have to cope with caring for an ageing population. And in the mid-2020s, on official projections, the working-age population will start shrinking. "There will be more dependents and at the same time fewer workers to support them," says Siri Tellier of the United Nations Population Fund in Beijing.

India, with an average age of 26, is a younger country than China (33), and has started to look on its growing population as a potential asset. A 2003 report by Goldman Sachs, an investment bank, on the four big emerging economies—Brazil, Russia, India and China—suggested that, alone among them, India's economy would continue to grow at more than 5% a year until 2050. Indians thought this was good news, despite two reasons for the conclusion: that it is the poorest of the four, so it has more to catch up on; and that its population will continue to grow until 2050, so its GDP per head will remain the lowest of the four, even by the middle of this century.

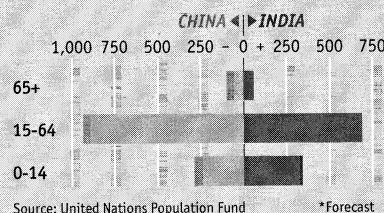
India, with an annual population

growth of 1.6%, twice China's rate, is expected to overtake its neighbour as the world's most populous nation around 2035. In other Asian countries, the bulge in the working-age population that India is now experiencing brought rapid economic growth. For India to achieve the same, however, it needs to educate its children better. That task will become harder, and the competition for scarce land and water more intense, as their numbers increase.

China, in contrast, will have more resources to devote to teaching fewer children. On Chinese figures, the fertility rate has fallen to 1.8. This is often thought to be an underestimate, because of the widespread breaches of the family-planning policies, but many demographers reckon it is actually an overestimate, a smoothing upwards of a figure that would otherwise have shown too drastic a decline. Clint Laurent of Asian Demographics, a research firm, says his people have cross-checked the number of reported births with other data from censuses and primary schools, and concluded that there has been overcounting to the tune of several million. He expects the working-age population to peak in 2009, at around 924m, and to decline to 835m by 2024.

More filling in the sandwich

Population breakdown by age group, 2005*, m



► then, both economies have seen spurts of growth. India's real GDP grew by an average of 5.6% a year in the 1980s and by 5.8% a year from 1991 to 2003. China's acceleration was comparable, but from a much higher starting point—9.3% in the 1980s, rising to 9.7% between 1991 and 2003.

A giant and a half

Because India's population has been growing much faster, GDP per person has diverged even more. China's grew by an average of 8.5% between 1990 and 2003, India's by 4%. As a result, China's national income per head in 2003, measured in cur-

rent dollars, was \$1,100, compared with \$530 in India: a staggering gap, given their recent parity. Adjusted for purchasing power, China has grown to be 70% richer than India.

According to Angus Maddison, an economic historian, who has studied the two countries from a "millennial perspective", two centuries ago China was slightly richer than India, but has been poorer for most of the time since then. In 1990 dollars, India's national income per head grew from \$533 in 1820 to \$673 in 1913, whereas China's declined from \$600 to \$552. By 1950, India's income per head was

Can India turn its growing population into a competitive advantage?

Yet many economists argue that China is likely to suffer from a labour surplus rather than a shortage for years to come. Already some say the internet has become a way of keeping the idle young amused. Shanda, an online-gaming firm based in Shanghai, reckons that its games attract an average of 1.7m concurrent players, the majority of them young men aged 18-24.

The other consequence of smaller families has been a sex ratio strongly skewed in favour of boys. In China there are 118 boys for every 100 girls born, compared with a natural ratio of 105 to 100. India's figures are also skewed, but to a lesser extent. The most recent census, in 2001, showed 108 boys under the age of seven for every 100 girls. In some of the most prosperous states, however, the imbalance is much more marked: in Delhi, for instance, the ratio at birth in the first half of last year was 122 boys to 100 girls.

In both countries, the alarming numbers result from a confluence of tradition and modern technology. Sons carry the family name and land and provide an insurance policy for old age; daughters go off to look after somebody else's old age, and, in India, require a dowry. As more people can afford to pay for ultrasound scans and illegal selective abortions, they choose to avoid the longer-term expense of having girls.

Nobody knows what effect this preponderance of boys will have on Chinese and Indian society in the future. The trend might correct itself as scarcity forces up the value of girls. Yet in prosperous northern Indian states, far from commanding a bride-price, women whose families have failed to stump up a sufficient dowry still get killed and disfigured. It is the saddest of market failures.

\$619 and China's \$439, although in absolute terms China's share of global GDP remained ahead. In every decade since then, China's growth in GDP per head has outpaced India's.

One consequence of this is that during the past century India's population and GDP have remained roughly constant as a percentage of the world totals (see chart 2, previous page). China's population, by contrast, has shrunk from a quarter to a fifth of the total. In the 20th century, it was ravaged by terrible natural disasters, as well as, in 1958-61, by the greatest man-made famine in history, which killed per-



haps 30m people. Since 1980 its population growth has been constrained by strict birth-control policies. Meanwhile China's share of global GDP, adjusted for purchasing power, has risen from 8.9% in 1913 to over 11% in 2000 and 13% last year.

In terms of international trade, the difference between the two countries is even more dramatic. In 1990, China's share of world exports was 1.9% and of imports 1.6%. By 2003 its share of exports had increased to 5.8% and of imports to 5.3%. Last year, two-way trade grew by 36% and China overtook Japan to become the world's third-largest trader behind America and Germany. In the 1990s, China's trade-to-GDP ratio went up by over 70%. No other country came close to that. India's increase was 23%.

Indian trade has also been growing fast, notching up a 16% rise last year. Even so, its total two-way trade last year was only around \$150 billion, less than 1% of the global total. For the third year running, the increase in China's trade was bigger than India's total foreign trade. This means the two countries have vastly different weights in the global trading system, but it has also changed mutual perceptions. Indian exporters, who two years ago feared that Chinese competition might be the end of them, now worry that a hard landing in China might destroy a big growth market.

China's foreign-exchange reserves are almost five times the size of India's, having increased by \$207 billion in 2004 to reach \$610 billion at the end of the year. As an engine of global growth, China has become an important partner in the economic debate among the rich countries. On its own figures, last year it contributed 12% of the growth in global merchandise trade. The exchange rate of its currency, the

yuan, pegged to the dollar at an artificially low level, has become a big issue in the world economy. Nobody seems to give two hoots about the rupee.

China's government as well as its people worry about rising inequality, but the rapid growth has brought a sharp drop in the share of the population living in poverty. According to the World Bank, the number of people living on less than \$1 a day, measured at purchasing-power parity, fell by about 400m between 1981 and 2001. "We have a lot of confidence that poverty has been almost eradicated," says David Dollar, who represents the World Bank in China.

For richer, for poorer

Not in India. According to Indian government figures, the number of poor in India fell by 69m between 1977 and 2000, but that left 260m still in poverty. The World Bank estimates that 35% of Indians live on less than \$1 a day, compared with 17% of Chinese. According to the Food and Agriculture Organisation, the number of undernourished people in China fell from 194m in 1990-92 to 142m a decade later. In India the corresponding numbers are 221m and 216m, meaning it is still home to a quarter of the world's undernourished. Some 47% of India's under-five-year-olds are underweight, compared with 10% in China. Infant mortality is 65 per 1,000 in India against 30 in China; life expectancy at birth is 63 in India, 71 in China; and adult literacy is 57% against 91%.

In the Human Development Index devised by the United Nations Development Programme, China, with a score of 0.745 (out of a possible 1), comes 94th out of 177 countries. India, with 0.595, comes 127th. Its officials take comfort from its rapid im-

provement—a 36% rise in its index score since 1980. As Amartya Sen, a Nobel-prize-winning economist, points out, the life-expectancy gap in favour of China, which was 14 years in 1979, has been cut in half. Life expectancy in parts of China may now actually be falling, such is the collapse of basic health care.

What is remarkable, however, is that on these basic measures of living standards China should have started from a base so much higher than India's. When China launched its reforms at the end of 1978, it had only just emerged from the nightmare of the Cultural Revolution and before that, the economic mass suicide of the Great Leap Forward. Yet when Mao Zedong died in 1976, he did at least bequeath his successors the human capital needed for growth.

Indeed, if, from a welter of dubious data, one were to pick out the most telling single statistic about the difference between India and China, it might well be female illiteracy rates. According to the World Bank, 87% of adult Chinese women are literate. The equivalent figure in India is 45%. Many things follow from educating girls: better health and education and longer lives for the whole family; more productive workers; and a boost to industrialisation and urbanisation. "An educated child", says Asian Demographics' Mr Laurent, "does not want to plant rice." ■



100% keen to learn

The insidious charms of foreign investment

China's cup overflows; India catches the spillage

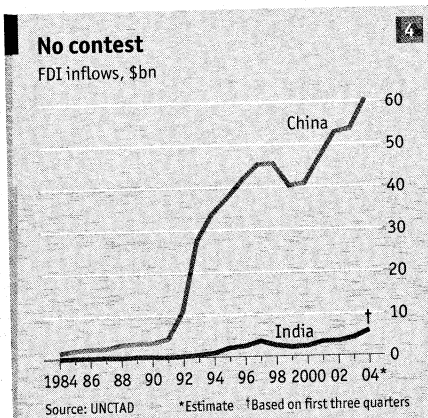
IN 1976, during one of Deng Xiaoping's spells of political disgrace, he was the object of a national campaign of criticism. Among the most heinous of his alleged crimes was writing an essay in which he argued, in Marxist terminology, that it was possible to import foreign "means of production" without importing the "relations of production"—in other words, opening up the economy need not change China's political and social system.

His critics—the Maoists shortly to be vanquished as the "Gang of Four"—saw this as heresy. Looking around China now, they might feel ashamed but vindicated, despite the Communist Party's enduring grip on power. Foreign trade and investment have transformed the party and the country. Some of the changes—to the environment, in particular—are hideous. But it is hard to argue that life in China was better 30 years ago than it is now.

No other country attracts as much foreign direct investment (FDI) as China does. Last year some \$60 billion poured in, about twelve times the amount that flowed into India. Between 1979 and 2004, China absorbed a total of about \$560 billion in FDI. According to a survey of big firms by A.T. Kearney, a management consultancy, India is the next most popular destination for foreign investment in manufacturing after China. But in the past four years it has received almost \$200 billion less in FDI than China has.

Rakesh Mohan, a respected economist who now works in India's Ministry of Finance, argues that this difference is overstated. Besides FDI, India attracts several billion dollars a year in portfolio investment (\$9 billion last year). It also draws in billions of dollars in deposits from non-resident Indians (\$33.3 billion outstanding last year), says Mr Mohan. Add all this up, and India is not so far behind China—especially if you allow for Chinese domestic investors "round-tripping", using foreign vehicles to take advantage of tax breaks.

It is not just a matter of money, however. Minority portfolio investors do not bring foreign technology and management systems, or competition that helps raise the efficiency of domestic firms. As for Indian banks, they are much healthier



than their Chinese counterparts and hence better placed to intermediate between savers and investors. But they still keep some 40% of their assets in government bonds.

The foreign-investment boom in China was started by overseas Chinese. From 1985 to 1996, two-thirds of foreign investment in China came from Hong Kong, Macau and Taiwan. There China has, close at hand, some 30m ethnic Chinese, many of them with close ties to the mainland. Moreover, these places specialised in labour-intensive manufacturing industries for export. Wage costs were rising fast, so, in effect, they exported their trade surpluses with America to coastal China. They were made very welcome, for political as well as economic reasons, and paved the way for the big multinationals.

Overseas Indians, in contrast, are scattered around the world and across professions. There are a number of global tycoons, tens of thousands of software engineers who powered Silicon Valley's dotcom boom, and millions of others. It is not surprising they have played a different role to that of the Chinese diaspora.

Build it and they will come

China has two main attractions for foreign investors: a potentially vast domestic market; and an environment from which it is easy to export. The first of these has often proved chimerical in the past, and people with money for discretionary spending are still in a minority, though a far larger one than in India: 300m as against 50m, on

one multinational's estimate.

Calculations by Asian Demographics showed that average urban household incomes in the two countries in 2002 were roughly similar. However, China has far more urban households. Because of the one-child policy, they are smaller—usually three people rather than five, as in India—and therefore have more money to spend. In 2002, some 70% of urban Chinese households earned between \$2,000 and \$7,500 a year. In India, a higher proportion earned more than \$7,500 (6.4% compared with China's 1.2%), but 73.5% earned less than \$2,000. China has a fairly broad-based middle class. India has a narrow affluent elite.

To take one example, consider the market for personal computers. India, despite its information-technology prowess, has one of the lowest penetration rates in the world. Forrester, a research outfit, expects this to increase by 37% a year until 2010, which means an extra 80m computers. But in the same period China will add 178m.

China's other big advantage over India is its infrastructure. It has 30,000km (19,000 miles) of expressway, ten times as much as India, and six times as many mobile and fixed-line telephones per 1,000 people. Although last summer saw serious power shortages in parts of China, India's supply is far more unreliable. In India, 61% of manufacturing firms own generators, compared with 27% in China, where the cost of power is 39% lower than in India.

There are pockets of excellence in India, such as the "campuses" built by the big software-development firms. But, by and large, they have had to do everything themselves, relying on their own power, communications systems and even bus services. Leave the campus and you re-enter the third world.

Even Bangalore, epicentre of India's IT industry, suffers from traffic jams, overflowing hotels, power cuts and an inadequate airport. It risks throwing away its great advantage: that it has attracted a critical mass of the world's high-technology firms to what could be a self-sustaining cluster and boomtown.

In China, provinces compete to lure investment. Parag Balakrishnan, of India's

► *Telegraph* newspaper, once accompanied a party of Indian businessmen to China and explains that they were flabbergasted, on approaching the northern town of Datong, to find their bus joined by the local mayor and given a police escort. Few Indian state officials or politicians go out of their way to attract foreign investors.

Hangzhou, the capital of Zhejiang province, makes an interesting comparison with Bangalore. Both have populations of around 6.5m and a wealth of colleges. Bangalore enjoys the best climate in India, and Hangzhou has an idyllic lakeside setting, so both have obvious attractions for technology firms. But Hangzhou's new airport opened in 2000, whereas Bangalore's has languished for years on the drawing board. Hangzhou is linked to Shanghai by a fast 100km (62.5-mile) expressway. Its charm may have been buried under new concrete, but it is ready for business.

Softly, softly

Ah! say Indians, but what about the people, and the "soft infrastructure", of laws, institutions and financial markets? Surely there India has a lead? Certainly, at the high end of the market, China cannot equal India's supply of technical wizards with fluent English. India's failures in elementary education should not obscure the excellence of some of its colleges.

Dan Scheinman of Cisco, the world's largest maker of networking equipment, says that Shanghai, too, has achieved a critical mass in the numbers of software engineers available. He finds it hard to differentiate between the two countries, either in the quality or the cost of their labour. In both, firms like Cisco are dealing with just a tiny fraction of the population, a group of exceptional people—though the churning of a workforce constantly on the lookout for a better job is a bigger problem in Bangalore than in Shanghai.

In labour-intensive manufacturing, however, Chinese workers, with their better elementary education, have a big advantage. World Bank research suggests that they are 25% more expensive than India's, but 50% more productive.

Corruption hampers business in both countries. In an index of perceptions produced by Transparency International, a monitoring group, India's score of 2.8 has remained constant for a decade. Anything below 3 indicates "rampant corruption". Last year it ranked 90th out of 146 countries (with the 146th being the most corrupt). In 1995 perceptions of China were even lower: a mere 2.16. But it has since



You name it, we make it

climbed to 3.4, and ranks 71st.

Even India's elaborate and well-developed legal system is not as much of an advantage over China as you might think. It is true that in some areas, such as the protection of intellectual property, India is far ahead. But Raj Pande, a lawyer with the firm Paul Hastings, observes that China, starting "with a clean slate" and unburdened by outdated rules, has the chance to build better regulatory frameworks.

Only a few years ago, Chinese outfits preferred contracts you could write on the back of an envelope and wriggle out of at will. Now, however, says Andrew Halper, who has worked in Shanghai for Everheds, a British law firm, "waves of foreign investment battering away", not to mention competition between locations, have brought more investor-friendly contracts.

Private-property rights are still far behind those of the developed world. But, argues the World Bank's Mr Dollar, China's property rights have improved far faster than other countries', and they are better than those in many other developing countries.

Enforcement of rights and contracts, however, remains troublesome, with the judicial corruption you would expect in a one-party state. But India is not a model in this regard either. It has a judicial backlog of an astonishing 26m cases. The contracts may be watertight, but you can get soaked waiting for a judgment. As Mr Pande points out, this clearly has a damaging effect on compliance.

Foreign investment in some sectors of the Indian economy—such as insurance and the media—is limited to a minority stake. In others, such as retailing, it is banned altogether. Even when liberalisation arrives, as it did in civil aviation late last year, it sometimes comes with perverse conditions attached (in this instance,

that foreign investors were welcome—unless they were foreign airlines).

China, too, has its limits, of course. But having entered the WTO on much tougher terms than did India, it is liberalising faster. The remarkable thing, says Gordon Orr, of the Shanghai office of McKinsey, consultancy, is how China has allowed foreigners to come in and dominate entire industries—carmaking, for example.

Jairam Ramesh, of India's ruling Congress party, blames the difference on the Indian bourgeoisie. China's capitalists were wiped out in the various purges of the 1950s and 1960s. India's middle class, however, nurtured under British colonialism and the "licence raj" of government-sponsored internal protectionism, is still in force to be reckoned with. So, too, unlike China, are trade unions, although they probably represent less than 5% of India's 400m-strong labour force.

India's trade unions and employees sometimes unite against a common foreign enemy. In January, for example, both groups opposed the government's decision to lift, for future projects, a rule known as Press Note 18 that acted as a deterrent to investment by giving Indian firms a veto over their foreign joint-venture partners and other investments in India. In China, communism had beaten both capital and labour into submission, though Deng's reforms were opposed by party conservatives and state-owned industry.

Who wants it anyway?

Is all that foreign commercial influence in China an unqualified boon? For unambitious foreigner and cosmopolitan Chinese alike, it may be a comfort that the country has 150 Starbucks coffee shops, but does it stunt native skinny-latte entrepreneurs, such as those behind India's Brista chain?

In a more sophisticated form, this was the question asked in an article in *Foreign Policy* in July 2003 by Tarun Khanna of Harvard Business School and Yasheng Huang of MIT. It caught Indian eyes with its mouth-watering title, "Can India Overtake China?", and its even juicier conclusion: that India's path "may well deliver more sustainable progress than China's FDI-driven approach".

In a book about FDI in China published in the same year, "Selling China", Mr Huang argues that the FDI China takes in shows up the huge deficiencies of its own corporate sector. "The cumulative result is that Chinese firms are less competitive than they would be otherwise." When a Chinese company emerges into the limelight, it is usually for a blunder or for sheer clout. Lenovo, for example, a computer-maker, late last year agreed to buy the personal-computer business of America's IBM. This said much about Lenovo's ambitions, but also about its inadequacies.

India, for its part, has fostered genuine entrepreneurship in some industries by favouring domestic investment over foreign. It has produced IT firms such as Infosys, Wipro and Tata Consultancy Services that are among the world's best. Mr Khanna says that, since the *Foreign Policy* article appeared, he has revised his opinion of Indian companies downwards. Outside the IT industry, many retain the bad habits and feuding that often afflict family firms. The biggest private-sector firm of them all, Reliance, a textiles and mobile-telephony giant, is torn by a bitter public squabble between its bosses, the late founder's two

sons. Mr Khanna's view of Chinese companies, however, remains that most are "anything but world class".

This is a fascinating debate. But, to put it crudely, so what? It hardly impinges on the big issue: how does a poor country become less poor? China has produced no great companies, although it is now the world's third-largest spender on research and development. Yet, in just two decades, China's people have, on average, become twice as rich as India's. Andy Xie, an economist at the Hong Kong office of Morgan Stanley, an investment bank, points out that very few of the firms that built the American economy at the end of the 19th century are world-beaters today—and yet they laid the foundation for the country's sustained long-term growth.

It pays to be profligate

The "so what?" also applies to the argument that India is much more efficient than China at using capital. Having invested an average of 22-23% of GDP for a decade, it has seen average economic growth of about 6% a year in real terms. China has invested twice as much, but its average growth rate has been only about 50% higher than India's. It is indeed staggering how much investment is needed to power Chinese growth. This measure (the incremental capital output ratio) has been climbing in recent years, but the investment figures include land sales, which makes them unreliable.

All the same, China has undeniably enjoyed an investment boom, which is why pessimists expect its economy to come

crashing to earth. Its growth of 9.1% in 2003 required investment of 42% of GDP, and last year's 9.5% probably needed an even higher ratio. Anywhere else, capital accumulation on that scale would look like a bubble. However, few economists in China and Hong Kong expect a hard landing, let alone a crash. First, they argue, there is no reason to expect investment suddenly to dry up. And second, there are signs that consumption is stronger than in recent years, and may withstand a falling-off in investment. For the first time in 20 years, consumption growth may be uncoupling itself from investment. Retail sales in December were up 14.5% on the same month in 2003.

India, meanwhile, is grappling with an even more fundamental difficulty: how to raise investment rates. To emulate China's growth, India would need to increase its investment to 30-35% of GDP, and there is little sign it can do that. Dominique Dwor-Frécaut, of Barclays Capital in Singapore, jokes that China's trouble is capital that costs zero. India's is zero capital.

Suman Bery, head of the National Council for Applied Economic Research in Delhi, says both countries face the same challenge: a failure of financial intermediation. Neither has found efficient ways to translate high rates of private savings into productive investment. China's answer has been FDI, leading to what Mr Bery calls the "idiocy" of Chinese peasant savings financing the American Treasury. In India, the consequences have been under-investment and a big fiscal deficit, financed by the banking system. ■

Sweatshops and technocoolies

India needs to emulate China's industrial revolution

THE justified pride that India takes in its IT prowess, and the outsourcing boom it has helped spawn, cannot disguise its irrelevance to the vast mass of Indians. The entire industry employs only about 1m people. According to estimates by NASSCOM, its lobby, income in 2004 from exports of software and services, and from outsourced services such as call-centres, reached nearly \$17 billion, equivalent to a quarter of India's merchandise exports. But the industry makes up only 4% of India's GDP, and only a small fraction of the service sector as a whole.

So the notion that India can somehow skip a development phase and jump straight to a post-industrial, IT-services-led economy is not taken very seriously. That it has any currency at all stems from a trend that at first sight seems odd: as agriculture's share in the economy has shrunk, its place has been taken not by industry but by services (see chart 5, next page).

The contrast with China is stark. There, as farmers leave the land they go into labour-intensive manufacturing. However, research by Jim Gordon and Poonam Gupta of the IMF has shown that, al-

though services make up a somewhat bigger share of its economy than is usual for a country at its stage of development, India is far from being an oddity. Rather, it is China that is peculiar in having such a stunted services sector. This may be a relic of the old Stalinist model with its emphasis on heavy industrialisation in the countryside. Or it may simply be due to the under-reporting of China's informal sector.

For India, it is nevertheless worrying that industry has, until recently, grown so much more slowly than services, and has provided so few jobs. The government's

► numbers show that in 2002 just 6.2m people were employed in manufacturing, fewer than in 1991 (6.3m)—though this partly reflects a change in definitions.

In China, about 160m people work in “secondary industries”, ie, manufacturing. One reflection of the country’s resounding success at becoming the world’s workshop was the global panic at the lifting of quotas on its clothing exports at the end of last year. Some forecasters thought that China might snatch as much as half of the big quota-constrained markets, the EU and America. India, by contrast, was expected to grab at most 15%, even though the business plays to Indian strengths—cheap labour, a domestic supply of both cotton and man-made fibres, and a long textile tradition. Yet here, as in so many other areas, India is following in China’s wake, not overtaking it.

Under Manmohan Singh as prime minister, the Indian government has recognised where it needs to concentrate its resources if the country is to raise its long-term growth prospects from about 6% a year to 8% or more. In speech after speech he and his ministers emphasise the importance of improving the lot of farmers, of raising levels of investment, especially in infrastructure, and of delivering elementary education and primary health care. In January, Mr Singh even spoke of adopting “the Chinese model”. But does that really make any sense in such a different political and social environment? It does, up to a point. Consider four areas: agriculture, investment in industry, government finances and foreign trade.

Down off the farm

In China, reform started in the late 1970s with the explosive burst of energy that came from the dismantling of the old rural collectives and communes. The “responsibility” system, in effect returning land to individual farmers, boosted rural incomes and freed tens of millions to work in new “township and village” industries. India has no hope of such a one-off miracle. But if it is to raise growth rates closer to China’s, it has to move people from the land into factories.

At present, roughly 70% of Indians live in the countryside, compared with 60% of Chinese (though some economists think the real figure is lower). Both countries face similar agricultural problems. After big surges in yields, productivity has stagnated, albeit at much higher levels in China than in India. In 2001, China produced 6,350 kilos of rice and 3,823 kilos of

wheat per hectare, compared with 2,964 kilos of rice and 2,742 of wheat in India.

Both have distorting price and subsidy regimes that favour excessive grain production. In both, many farms are too small and farmers too poor to invest in inputs. There is little access to rural credit. Land has been degraded, water is scarce, and in many places groundwater has been extracted at unsustainable rates. There is mounting competition with cities and industry for land and resources.

Already, many farmers are idle much of the year. Large numbers are on the move from fertile places with a labour surplus, such as Sichuan in China and Bihar in India. In China the number of migrant workers is estimated at anywhere between 100m and 150m, despite a restrictive registration system (“hukou”). India, by contrast, has comparatively few: about 11m in 1999-2000, according to national surveys.

The absence of mass migration in India also reflects the poor levels of basic education and the lack of job opportunities. That is partly explained by the barriers to investment, which the government has pledged to lift. Some are already vanishing as the relics of the licence raj are dismantled. Every year, for example, more products are freed from the rules “reserving”

their production for small businesses (though they still cover 600 items, such as hairbrushes and socks).

Firing workers remains hard in India, which deters firms from hiring them in the first place. This has a big impact on productivity. Many firms feel unable to reap economies of scale, because once they employ more than 100 people they become subject to the restrictive labour laws. In China, at first only in the four Special Economic Zones set up in 1980, but nationwide later that decade, companies were given the freedom to lay off staff and to link pay to performance.

Indian bureaucracy continues to slow things down. According to a World Bank “Investment Climate Assessment” published last November, it takes 89 days to secure all the permits needed to start a business in India, compared with 41 in China. Insolvency procedures take ten years, compared with 2.4 in China.

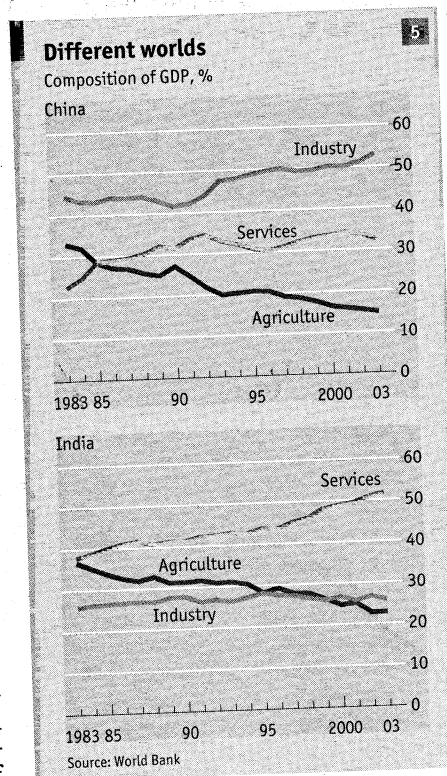
Access to land is a further obstacle. Ownership is often unclear, use and transfer are subject to many restrictions, and land transactions incur high stamp duties. All of this restricts the supply of land and pushes up prices. According to the World Bank, land prices relative to incomes are ten times higher in Delhi and Mumbai than in Tokyo.

Fixing that hole

For both domestic and foreign investors, India’s poor infrastructure remains a huge barrier. Again, the government recognises this. But a combined state- and central-government deficit of about 10% of GDP for the past seven years leaves little leeway to build for growth.

China hardly seems a model in its handling of public finances. Although its consolidated fiscal deficit is modest, at 2.5% of GDP, the budget is opaque, and there is a vast disguised deficit in the form of the mountains of non-performing loans—as much as 40-50% of the total—that have piled up in the banking system. For years, the banks eased the pain of restructuring loss-making state-owned industries by continuing to throw money at them. They also financed a large part of that impressive infrastructure, built by bankrupt local governments.

However, China has shown India the way in one respect: tax reform. There is much waste in the Indian budget, notably in the form of ill-directed price subsidies. But most expenditure is hard to cut: mainly interest payments (about 44% of recurrent expenses), but also defence and civil-ser-





The road to riches

► vice wages and pensions. If India's government is going to make a difference, it needs to raise more taxes.

Central-government tax receipts have actually fallen as a percentage of GDP since the reforms of 1991, from 10% to around 9% now. In China, over the same period, they have risen from 15% to 19% of GDP—and GDP itself has grown from 124% the size of India's to 240%. China's government simply has far more money to spend than India's does.

India's tax system suffers from widespread evasion of direct taxes and a proliferation of confusing indirect ones. To counter the first problem, officials sometimes toy with the idea of replacing all the

currency in circulation, to trap those who have profited from the many deals still transacted with suitcases full of used 100-rupee notes. Simplification of a system riddled with exemptions, discretion and arcane rules would also help.

As for the second, India is, from April 1st this year, to make its fourth attempt at introducing a national value-added tax (VAT). China's experience is encouraging. Before 1994, the country's tax system suffered many of India's current woes: a confusion of cascading state and municipal sales taxes, state-border taxes, excise duties and levies. Now it has a single VAT, levied at 17% on most manufactured goods in all provinces. This provides a steady

one-third of the government's tax revenues. Import tariffs have fallen from 10% of government tax revenues in 1985 to about 5% now, and direct corporation and income taxes from about one-third to 15%.

Properly implemented, India's VAT could have a similar impact. Eventually it would also speed up freight, as lorries would no longer have to stop at state borders. Because a company pays tax only on the value it has added, claiming back the tax it has already paid on inputs, VAT should also, in theory, be less easily evaded, and in time increase government revenues.

That should also help the government cut customs duties, which at present account for about one-sixth of its tax revenues. India's average import-tariff rate, at 20%, is about double China's. Cutting it would do much to spur competition and improve industry's productivity. In some industries Indian manufacturers have already shown that they can compete with the best in the world. Once the government's inhibiting protection has gone, there is no reason why they should not do so in others.

Reforms that would, in time, improve manufacturing competitiveness should also help reduce the fiscal deficit. That, in turn, would help lower the cost of capital, and allow more government spending on the big needs: infrastructure, education and health. In Deng's era, there was a popular phrase in China: "To get rich, first build a road." And, one might add, use it to take girls to school. ■

Two concepts of liberty?

Democracy and growth are not in competition

PUT ten Chinese in a room, goes an old joke, and you would be hard pressed to get them to speak. Put ten Indians together, and you would never get them to shut up. It is a gross generalisation, but anybody who has worked in both countries would recognise a grain of truth, in political as well as cultural terms.

China is incomparably more relaxed than it was a generation ago. People are still not free to bring about political change, but they are, by and large, free to ignore politics. Yet it is still a one-party dictatorship where the one party has remained in power only because, in 1989,

the army shot people to keep it there. Tens of thousands of people are locked up merely for exercising their rights to freedom of expression, association or belief. Torture and ill-treatment remain widespread. All of this is bound to breed a certain diffidence.

In India, on the other hand, every shade of opinion is noisily expressed. Pratap Bhanu Mehta, of Jawaharlal Nehru University in Delhi, in a book called "The Burden of Democracy", quotes Clement Attlee, a former British prime minister: "Democracy means government by discussion, but it is only effective if you can

stop people talking." India, it sometimes seems, will never reach that point.

Arun Shourie, an Indian journalist, economist and former privatisation minister, expressed a similar exasperation in 2003 when the proposed sale of government shares in two oil companies was blocked by a Supreme Court ruling: "This is the difference between India and China. In India everybody has a veto."

This is an excuse often given for the maddeningly slow pace of reform in India, its stop-go cycles and its constant backpedalling. In China, goes the argument, the government or party no sooner issues an

► order than it is done. A mind-boggling scheme to dam the Yangzi river and generate electricity at the Three Gorges, involving the forcible resettlement of 1.3m people, the destruction of priceless cultural relics and the risk of silting, flooding and the nightmare of an earthquake? No problem. By contrast, in India, the argument continues, such pharaonic ambition would not stand a chance.

There are three obvious objections to this. First, China is not a monolith, and decision-making there can also be painfully slow (for example, the Three Gorges project was first mooted in the 1920s). Second, that this could never happen in India might be a good thing. And third, India has had its own controversial grandiose projects, including dams. But most Indians seem to accept that a more indecisive, less radical government is the price of democracy. As Jia Qingguo, a professor of international studies at Beijing University, puts it: "Democracy in essence is a conservative arrangement. If all interests are represented, how can you make rapid and fundamental reforms?"

The compensation for Indians is stability. Except for the brief interlude of "emergency" imposed in 1975 by Indira Gandhi, the then prime minister, Indian democracy has stuck. It may have seemed an improbable experiment in such a poor, ethnically divided and hierarchical society, but it has proved resilient and deep-rooted. Turnout at elections is higher than in many developed countries—and it is the poor who vote in large numbers. The system

may not deliver economic growth rates of 9-10%, but nor has it imposed Mao Zedong's murderous millenarian lunacies.

India's stability should not be taken for granted, and it is relative. It has encompassed several insurgencies, in Punjab, Kashmir and the north-east, and a long-running Maoist rebellion that has affected a quarter of India's 593 districts. On several occasions, most recently three years ago in Gujarat, parts of the country have been scarred by vicious communal violence. The war in Kashmir, whose flames are fanned from Pakistan but whose fuel is disaffection with Delhi, has taken perhaps 60,000 lives, and seen Indian forces engage in persistent human-rights abuses. Yet none of this has posed a systemic threat to India's democratic structure.

In China, by contrast, the big question is how a party that presided over such catastrophic blunders and crimes, in particular the famine of 1958-61, has managed to remain in office. Only recently has it offered anything resembling stability. Indeed, the 15 years since the Beijing massacre of 1989 are not only the longest period of relative political calm since "liberation" in 1949; they probably represent the longest such period China has enjoyed since the Opium Wars of 1840. Professor Jia argues that the present stability dates back to the Deng Xiaoping restoration of 1978. The protests in 1989 were, in retrospect, "a minor interruption". That is indeed how it now seems, though by the party's own account at the time, "serious turmoil" afflicted dozens of China's cities.

On this view of India, it has chosen stability of a sort over growth. In the words of Meghnad Desai, an Indian-born economist, "to stay a peaceful and stable society India has to be a muddle and a mess." India has more than a billion people, 29 states enjoying considerable autonomy, 33 main languages and 1,650 dialects, and six main religions, one of which—Islam—is followed by 13% of the population. A slow-moving but flexible democracy is the only way of holding all this together.

The corresponding analysis of China is that there the party has done the choosing. It has opted for growth over freedom, imposing stability by force. The people accept this because the party has delivered on its side of the bargain, and because it has generated nationalist enthusiasm for regaining China's place in the world, overturning a century of humiliation at the hands of foreigners.

Like India, China is as big and diverse as a continent, though it is ethnically far more homogeneous, with more than 90% belonging to the Han majority, and has spent far more of its history as a united nation. But, argue the doomsayers, because China has no institutional framework for managing dissent, and because its ossified political structures cannot cope with the economic transformation of the country, it risks a huge explosion: "The Coming Collapse of China", as one book title succinctly puts it.

Blame the player, not the instrument

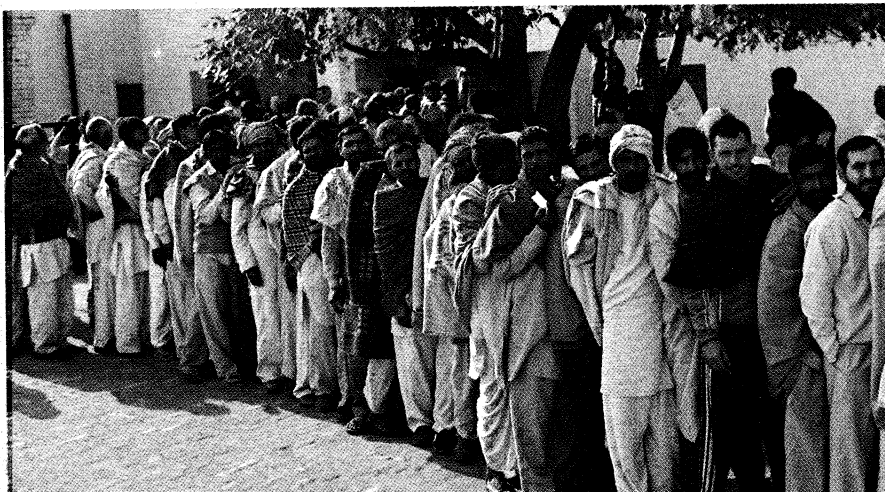
These caricatures of the two countries do democracy an injustice. It is not to blame for India's relative poverty. After Jawaharlal Nehru became independent India's first prime minister in 1947, his Congress party enjoyed three decades of uninterrupted rule, most of them with a large parliamentary majority. It took the chance on offer to make radical choices and changes. It is not democracy's fault that many of them were the wrong ones.

But that is not to deny that India needs political reform. Again, the present government talks much sense on the issue. But the very reasons the system needs an overhaul may make it impossible to implement. There are three main needs: for better politicians; for less fragmented ruling coalitions; and for greater decentralisation.

In every country, politics attracts some unsavoury characters, but India may be worse than most. According to research by the Public Affairs Centre (PAC), a Bangalore-based monitoring outfit, of 541 members of the lower house of parliament ►



Party piece



The slow business of democracy

► elected last year, nearly a quarter faced criminal charges. The proportion is higher for less educated MPs, who also tend to be richer. "Do political parties attract them," asks the PAC, "because they compensate for their low education through their asset power and criminal prowess?"

More than half of the MPs facing charges that could lead to lengthy prison sentences come from just four states in the Hindi-speaking "heartland" of northern India: Bihar, Jharkhand, Uttar Pradesh and Madhya Pradesh. In these places there is a special risk of criminals seizing political power, operating like warlords and sometimes winning election by "capturing" polling booths by force. Office holds out the chance of political protection from prosecution, as well as of income from corrupt practices.

A stalwartly independent Election Commission does its best, but it faces an uphill struggle. Late last year, for example, Laloo Prasad Yadav, the political boss of Bihar (and railways minister in the federal government), was caught on camera dishing out 100-rupee notes to crowds of poor people, apparently to encourage them to attend a rally before the state elections in February. The Election Commission let Mr Yadav off with a "severe reprimand".

The chief election commissioner has expressed sympathy for the idea of giving voters the option to reject all candidates on the slate, but that would achieve little beyond perhaps a healthy embarrassment. Speeding up the judicial process so that more guilty politicians spend time in jail rather than parliament would help. However, some argue that the only way to attract higher-quality candidates and ensure fair contests is to finance election campaigns with public money.

The second political obstacle to reform is the growing power of change-resistant regional and caste-based parties like Mr Yadav's. Last year's election was portrayed as a triumph for Congress over the Bharatiya

Janata Party (BJP), the Hindu-nationalist party that led the previous coalition government and is now the main opposition. That disguised a more important trend. For the first time since 1996, these two big national parties won less than half of the total vote (49%). State and special-interest parties have increased their share from 21% in 1989 to 37% (see chart 6). In only one of India's six most populous states does either of the two big national parties have a majority in the state legislature.

Three ideas of India

Coalitions, which have formed the last three governments, seem likely to rule India for years to come. The present one involves more than 20 parties. This can have a healthily moderating effect. In office, the BJP, for example, had to refrain from controversial policies promoting the interests of Hindus in order to keep its coalition together. But it can lead to paralysis. The present government faces debilitating rows with its coalition partners and "outside supporters" (mainly Communists) over every reform—be it a small cut in the above-market interest rates paid to pensioners on their provident-fund accounts (subsequently withdrawn) or the permissible level of foreign investment in the telecoms industry.

Keeping coalitions together is not just a handicap in making policy. It is expensive. Lord Desai points out that the fiscal deficit grew in tandem with the decline of the big central parties. He argues that the various parties have three different ideas of India. Congress is Nehru's heir, and custodian of his vision of a united, secular, syncretic India. The BJP is the party of the Hindu majority, with a view of a proud, resurgent Hindu nation. Most of the smaller parties, however, are subnational. The Communists are hardly an exception, so geographically defined is their strength. Their appeal is to caste, regional or linguistic loyalty.

Politics becomes a matter of redistributing the national cake, not baking a bigger one. Nor are voters foolish to elect them. These narrowly based parties, offering only to advance the interests of their "vote banks", may actually be better at keeping their promises than those pledging economic development.

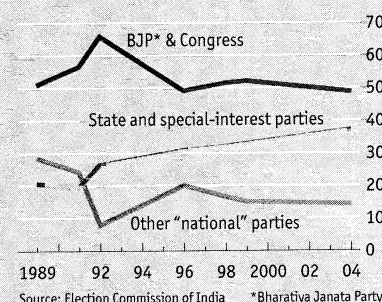
Lord Desai's solution is for the two parties with a "unitary" vision of India—the BJP and Congress—to work in coalition. Because each is committed to raising India's long-term growth rate, and broadly agrees on how to achieve that, this makes some sense. But because each defines itself in opposition to the other, it seems fanciful. Likewise, given the difficulty of forging consensus and of persuading politicians to acquiesce in loss of power, some of the ideas floated by members of the present government seem unrealistic. Prithviraj Chavan, for example, a minister in the prime minister's office, has suggested laws limiting the number of parties contesting national elections. Salman Khurshid, another Congress leader, has proposed introducing some proportional representation into the electoral system, with candidates chosen from a national list.

However a government is elected, it is likely to suffer from corruption. Rajiv Gandhi, a prime minister in the 1980s, once said that, of every 100 rupees of public money spent on the poor, only 15 ever reach them, and he is still often quoted. Many argue that the best way to monitor the graft of elected and non-elected officials is to devolve decision-making—and funds—to the lowest levels of elected government, the village councils or *panchayats*. Efforts to do so in the past have often been thwarted by the vested interests under threat. This government has promised a renewed effort.

If political reform in India seems daunting, in China it is life-threatening. There

The rise of the little guy

India's general elections, % of votes



► has been some change at local level. Elections have been held in villages and in some urban districts, and in some party and state bodies. Meanwhile a proliferation of new outlets and growing internet usage have broadened the scope of allowed discourse. But the party has never contemplated relinquishing its monopoly on power.

Two million mutinies now

Hopes that Hu Jintao, who took over as the party's leader in 2002, might usher in a period of faster political change have been dashed. Mr Hu has ruled out a separation of powers on the western model. According to Tony Saich, a China expert at the Kennedy School of Government at Harvard, he clings "to the belief that the answer lies in improving the quality of local officials and instilling in them a more

upright, moral vision of what a good official should be". As Mr Saich points out, this is in all but name a Confucian notion: "the rectification of names".

How fragile does this rigidity leave China? There are plenty of causes for disaffection: inadequate compensation for farmers' requisitioned land; no work and no welfare system for migrant labourers; large-scale corruption; and sharply rising inequality. According to police statistics, the number of public protests in China in 2003 averaged about 160 a day. The protests in 1989, and later the mushrooming of the Falun Gong cult, showed how quickly popular enthusiasms can spread. But the party has made sure it faces no national opposition that might join these isolated protests into a co-ordinated movement.

Mr Saich oversaw a survey in 2003 in which people were asked about their level

of satisfaction with the government. They grumbled about local authorities, which are responsible for delivering services and often fail. But on the whole they were happy with the central government. This suggests it is given some credit for its national role: it is guiding China to great-power status. It will remind its people, and the world, constantly of this as it prepares to play host to the 2008 Olympic Games.

Sooner or later, however, the party will have to loosen its grip. Optimists argue that a number of countries have managed impressive "catch-up" growth under authoritarian systems—for example, Germany, Japan and the Soviet Union. One could add Taiwan and South Korea. But none has stayed in the first rank without democratising. Leadership demands innovation. And, for all its failings, democracy is better at producing that. ■

Rivals and partners

Are India and China coming together?

AN UNSTATED assumption of this survey has been that India and China are rivals. That is certainly the way it seems from India. In economic growth, global influence and military might, India cannot help but measure itself against its neighbour. Ever since China's rout of India in a brief but bloody war in 1962, this comparison has been tinged with a sense of injustice, humiliation and suspicion.

But this is a rather one-sided competition. India desperately wants the international standing and respect that China already enjoys. In particular, it wants this status symbolised, as China's is, through a permanent, veto-wielding seat on the United Nations Security Council. If China measures itself against any country, however, it is America.

Its relationship with India, moreover, is changing: diplomatic relations are better than at any time since 1962, and trade is booming. The two civilisations have cultural, religious and trading links dating back 2,500 years. They are not doomed to be enemies. So is this the dawn of a new era of partnership and co-operation, the creation, as some suggest, of an "India-China nexus" that will change the world?

There are strong grounds for scepticism. First, Indian suspicions of China run deep, and the disagreement that caused

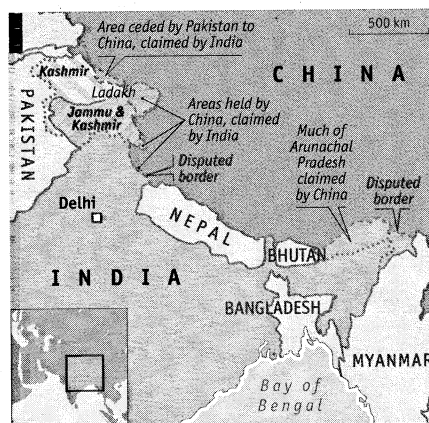
the war still looms large. Usually labelled a "border dispute", it is not some minor cartographic tiff. India claims an area of Chinese-controlled territory in Ladakh, Kashmir, that is the size of Switzerland. China's claim to what is now the Indian state of Arunachal Pradesh covers an area three times bigger (see map). Since 1988, working groups have been meeting to discuss the dispute. Their main aim has been not so much to reach agreement but to shelve the issue, allowing relations to improve in other areas.

New impetus was injected, however, when Atal Behari Vajpayee, then India's

prime minister, visited China in 2003. Talks on the border dispute were moved to a much higher level. A settlement involving swapping claims and making some minor border adjustments still seems remote, because of the political difficulty of selling such a deal in India. But it is no longer inconceivable.

Beijing University's Jia Qingguo argues that a renewed Chinese interest in India was in part provoked by America's attempts under the Clinton administration, and, until September 11th 2001, under George Bush as well, to "use India to contain China". Kishore Mahbubani, a Singaporean former diplomat who now heads the Lee Kuan Yew School for Public Policy, makes a similar point: that China is "buying political insurance now" through all its neighbours. It knows America will be alarmed by its emergence as a great power and, far-sightedly, wants those neighbours to share in its prosperity.

China's "all-weather" friendship with Pakistan has always complicated relations with India, though China has long stopped voicing explicit support for Pakistan's stance on Kashmir, and appears to have played an important role in 2003 in persuading it to start serious peace talks with India. But some Indian analysts still point to China's "strategic encirclement" ►



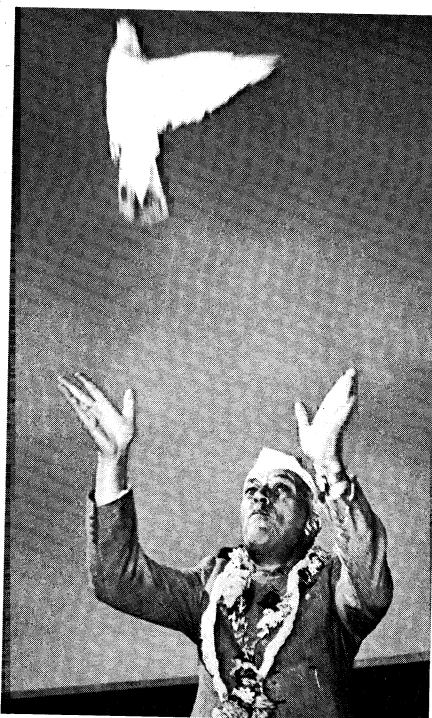
► of India—ie, its attempts to make friends with all of India's neighbours, from Sri Lanka to Myanmar. When India became a declared nuclear power in 1998, Mr Vajpayee wrote to President Clinton to explain his reasons for the move, citing "an overt nuclear weapons state on our borders, a state which committed armed aggression against India in 1962". China, which had reacted calmly to India's bomb, was peeved at being used to justify it.

Chinese officials implied that, if India wanted an arms race, China was ready. Such sabre-rattling has died down since then. But as China's economy grows, it will probably want an army to match its economic might. India may find it hard to believe that Chinese intentions are benign. One Chinese scholar sees similarities between Indian attitudes to China and Chinese attitudes to Japan. The animosity in Sino-Japanese relations is far more deep-seated, but there is the same mixture of historical grudge and present envy.

India and China may also find themselves in competition for resources, especially energy. In the period up to 2020, Chinese demand for oil is expected to grow by almost as much as America's in absolute terms. India is also dependent on imported hydrocarbons, and is hungrily seeking long-term supplies of oil and gas. In one sign that the two countries might co-operate as well as compete, India in January announced it had acquired a 20% share in the development of Iran's biggest onshore oilfield, which is operated and 50% owned by Sinopec, China's state-owned oil company.

As relations have improved, there has been much talk about the "complementarity" of the two economies. With Indian software and Chinese hardware, goes the refrain, the world will be at our feet. Looked at from the perspective of American multinationals, shifting some of their manufacturing to China and some of their back-office processes to India, this makes some sense. But its application to direct Sino-Indian economic exchanges seems limited for now.

Fast as they are growing, these are still small. The two countries' bilateral trade, in which India enjoys a surplus, has been growing by leaps and bounds, to reach \$13 billion in 2004. But that is just 1% of China's global trade, though 9% of India's. There are only seven direct flights a week between India and China, compared with, for example, six a day between Shanghai and Bangkok alone. In 2003, of the 11.4m tourists who visited China, just 211,000



Nehru couldn't make it fly

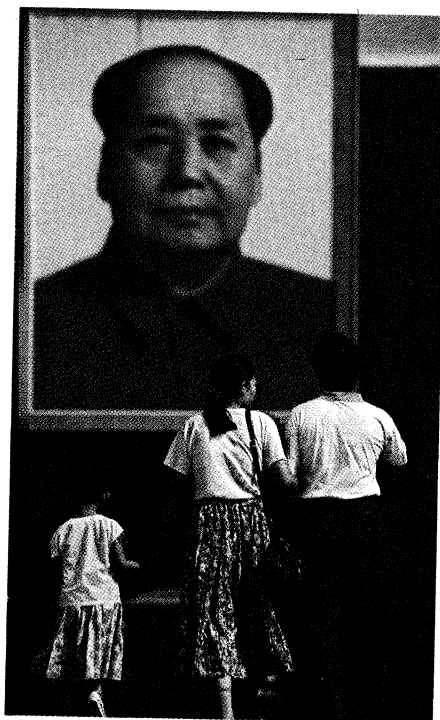
were Indian; and only 21,000 Chinese visited India.

Investment flows are still small. Huawei, a Chinese telecoms-equipment firm, employs several hundred software engineers in Bangalore. Chinese white-goods makers such as Hai'er are fighting for market share in India. In the other direction, Indian software firms are setting up in China, and some firms are manufacturing there.

Indian companies' interest in China (like that of many multinationals) remains focused mainly on export markets, or on the foreign sector within China. Tata Consultancy Services, for example, India's biggest software firm, has a development centre in Hangzhou where it employs some 200 people. Its regional director, Girija Pande, says it was drawn to China by the needs of its multinational clients. Only a small proportion of its work there is for Chinese customers.

Similarly, in manufacturing, Orind Refractories, an Indian firm that has been making refractory bricks for steel furnaces in China's north-eastern Liaoning province for ten years, exports 98% of its output, despite a huge demand for the bricks in China itself. Competing with local firms is hard, and getting paid is even harder.

First Eastern, a Hong Kong-based private-equity firm that has invested in 80 projects in China, is planning to launch a \$200m fund to invest in Indian ventures in China, Chinese projects in India and joint ventures in third countries. Victor Chu, First Eastern's boss, says the aim is "to realise the largest potential synergy" in Asia. He sees opportunities in, for example, pharmaceuticals, and Chinese tourism to



Mao is still watching

India. One Indian pharmaceutical firm, Ranbaxy, has been manufacturing in China since 1995, and outbound tourism is growing fast.

From such a low base, it would be surprising if two-way trade and investment flows did not increase rapidly. But China is becoming so integrated with the rest of the global economy that it is hard to see how its business with India alone will make a huge difference.

Soft and hard

India and China will have what Mr Chu calls a "competitive partnership". In India, the Chinese bogey is constantly invoked as the biggest potential threat to India's lead in exports of IT services and outsourcing. China, it is argued, is only a few years behind in producing similar numbers of software engineers and of English-speaking graduates. Such is its clout in the global economy that it will prise India's one undisputed niche away from it.

Useful though such warnings may be in keeping Indian firms on their toes, they seem a bit far-fetched. Some outsourcing operations, such as call-centres, are already setting up in China. GE Capital International Services, an India-based back-office-services firm set up by General Electric, is one of several firms with operations in Dalian in China's north-east, ►

► where it employs more than 1,000 people. From there, it can provide services both to China and to Japan and Korea.

In those markets, Indian IT-services firms will certainly find themselves at a disadvantage. But in services requiring fluent English-speakers, it is likely to retain its lead for a long time yet. The same applies to software. The Chinese software industry is fragmented, focused on its domestic market and inexperienced in dealing with the complex collaborative development projects in which Indian firms excel.

The next China?

The more interesting and important question is whether India can compete with—or at least emulate—China in labour-intensive manufacturing for export. There is no other way that Indian economic growth can be raised consistently to match that achieved in China in the past two decades. Some Indian manufacturers remain in awe of China's ability to grab and dominate a market. Rahul Gupta, managing director of Phoenix Lamps near Delhi, for example, says that in one of his firm's products, compact fluorescent lamps, China has 65% of the global market. China's role as the global economy's manufacturing hub is unstoppable, and India has "missed the boat".

Phoenix refuses to compete head-on with Chinese lampmakers. Their prices are unbeatable. Mr Gupta, and many others, attribute this to a variety of open and hidden subsidies: an undervalued exchange rate, cheap credit with few penalties for default, underpriced land, unpaid suppliers' bills, export subsidies and so on. Phoenix's response has been to move up-market and compete on quality in less price-sensitive markets.

That has been the story for many of India's successful exporters. But is the battle for the bargain basement really lost? Orind's boss, Rajeshwar Mishra, for one, is optimistic that, within two to three years, India will be more attractive to manufacturers than China is. Rising labour costs in China will force them to look elsewhere.

India hopes to be, in a phrase often heard, "China 15 years ago": on the point of becoming an export powerhouse. Hong Liang, an economist with Goldman Sachs in Hong Kong, says that, even in China, this idea is attracting attention. Policymakers have noticed, she says, that the emergence of China as a lower-cost competitor was a proximate cause of South-East Asia's financial crisis in 1997. Looking around for the source of such a threat to China, India

is the obvious candidate.

As this survey has argued, India is not going to play that sort of role without radical change. Many think it will never happen, and argue that this does not matter: India is doing very well, growing faster and lifting more people out of poverty than ever, against a political and social backdrop immeasurably more complex than China's. The comparison is pointless; the two countries are just too different.

That may be true. But India needs to raise its growth rate not as part of some artificial race with China, but for its own sake. Because of its population profile, not to do so would bring a big rise in unemployment, with all the misery that implies. The obstacles are certainly daunting, and include some political reform. Elections in February in Bihar, India's most backward state, and the one where crime and politics have become least easily distinguished, served as a reminder of how difficult that will be in India's federal system. The growth of parties relying on particular lower-caste groups for their votes has led to unwieldy and often ugly coalition politics. But in a democracy, that is not a reason for making it harder for such parties to share power.

One consequence of this may be to widen the gap between the richest parts of India and those, like Bihar, that have been left behind. In both India and China, one of the big challenges of the next few years will be managing regional differences. Just six of India's 29 states attract almost all the foreign investment that comes into the country. China faces a comparable gap between its booming coastal provinces and the poorer interior. But its central govern-

ment is better able both to dictate provincial policy and to invest in its backward western regions.

How the two countries cope with these and other social tensions will in part determine whether they can maintain or (for India) raise their present high rates of growth. China does not have the safety valve of regular competitive elections, but nor are there signs of an imminent explosion. India's political structure has shown itself well able to absorb all manner of shocks, but not, as yet, to achieve sustained radical growth-enhancing reform. Many would agree with Lord Desai's conclusion: "China will again become a viable Great Power; India may become just a Great Democracy."

It is worth recalling, however, that when India launched its reforms, in 1991, the future of China's reforms was itself in doubt. After the Tiananmen protests in 1989, there was renewed infighting within the Communist Party about how far and how fast to push "reform and opening". It was only Deng Xiaoping's "southern tour" in early 1992 that decided the debate conclusively in favour of a rush for growth.

India's position now is broadly similar. Economic reform has worked, as it did in China, but the country continues to face resistance from vested interests. Last year's election, seen as a rebuff to the politicians by the neglected rural poor, is sometimes interpreted as a vote against reform. But it was largely a vote against non-performing governments and, in that sense, a ringing call for more radical change. It showed that Indian voters understand the essential truth that Deng grasped about pre-reform China: "The old stuff didn't work." ■

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